

Sectoral change is slowly progressing, against the background of an already strong service sector. The shares of the agricultural sector in output declined slightly to 7% in 2005 (7.2% in 2004). This was 62.2% for the services sector (62.5% in 2004). Industry's share (including construction) rose to 30.8% (2004: 30.3%). The share of employment in agriculture rose to 17% (2004: 16.2%), declined slightly for industry to 28% (2004: 28.4%), and rose further for the services to 53.7% (2004: 53.5%).

A growing sector of small- and medium-sized enterprise (SME) still has to cope with a difficult business environment. The relative importance of the SME sector has recently grown. It represents 99% of the total number of firms and 65.5% of total employment. SMEs generate 55% of GDP and 25% of exports. They represent 38% of total enterprise assets. Despite various government initiatives, SMEs have continued to be confronted with inefficiencies in the administrative and judicial system. Access to longer-term financing has remained problematic, particularly for small businesses. The support of SMEs has remained an important priority of the government's medium-term economic policy strategy.

#### *State influence on competitiveness*

Progress has been made in enhancing transparency on state aid issues through the establishment of a state aid inventory. A new state aid law came into force in late 2005, bringing legislation more in line with EU requirements. State aid granted remained high at around 2.8% of GDP in 2005. A large part represents support to specific sectors, such as shipbuilding, steel, aluminium and railways. Horizontal aid accounts for only a minor share of state aid, although its relative importance has risen recently. The government announced its intention to reduce the share of subsidies to 2.1% of GDP by 2007 in the context of the PEP 2005. This will require bolder steps in cutting state aid to non-viable, loss-making companies, either through restructuring and privatisation or liquidation. Overall, state intervention in the productive sector remains significant.

#### *Trade integration with the EU*

Croatia is an open economy with total trade representing more than 100% of GDP. In 2005, the shares of imports and exports of goods and services in GDP slightly went down to 55.8% (2004: 56.7%) and 47.1% (2004: 47.4%), respectively. Tourism remains the most important export revenue, representing 18% of GDP in 2005 (2004: 17.8%). The EU has continued to be the most important trading partner with a share of 64.6% in Croatian exports and 65.6% in imports. Both shares were slightly lower than in 2004. At the same time, Croatia has expanded its trade with developing countries and its neighbours in the Western Balkans. In summary, Trade integration is fairly high and trade with neighbouring countries has grown.

Price competitiveness has been maintained. The real effective exchange rate of the Kuna measured on the basis of consumer price developments has remained stable through 2005. Wage and labour cost developments also indicate that price competitiveness has been maintained in 2005. Real unit labour costs declined by 2.3% as real wage growth (1.2%) was lower than the growth of average labour productivity (3.6%).

#### **4. ABILITY TO ASSUME THE OBLIGATIONS OF MEMBERSHIP**

This section examines Croatia's ability to assume the obligations of membership – that is, the *acquis* as expressed in the Treaties, the secondary legislation, and the policies of the Union. It

also analyses Croatia's administrative capacity to implement the *acquis*. The analysis is structured in accordance with the list of the 33 *acquis* chapters.

#### 4.1. Chapter 1: Free movement of goods

Little progress has been made regarding alignment on **general principles**. Croatia needs to make sure that its legislation, including distinctly as well as indistinctly applicable measures, be compatible with Articles 28 – 30 of the EC Treaty and related jurisprudence.

As regards **horizontal measures**, governmental decrees dating from October 2004 provide a legislative basis for the separation of the regulatory, accreditation, standardisation and metrology functions previously fulfilled by the State Office for Standardisation and Metrology (DZNM). The decrees notably included the establishment in February 2005 of the State Office for Metrology (DZM) as a new governmental body and two new public institutions, the Croatian Standards Institute (HZN) and the Croatian Accreditation Agency (HAA), which started operations in July 2005. The separation of their functions was finalised in 2006.

As regards *standardisation*, HZN had transposed 8,173 harmonised European standards (ENs) by September 2006, or about 66.6% of the CEN and CENELEC standards. By the end of May 2006, the number of HZN staff was 46 and recruitment of additional staff is underway. HZN is an affiliate member of the European Committee for Standardization (CEN) and the European Committee for Electrotechnical Standardization (CENELEC), but does not yet have a target date for full membership in either body.

In the area of *accreditation*, since July 2005, HAA has recruited new staff, trained assessors and promoted accreditation among governmental institutions responsible for harmonisation of New and Old Approach directives.

HAA has been a full member of the European Co-operation for Accreditation (EA) since November 2005. HAA employed 17 persons at the end of May 2006 in comparison with a number of staff of eight when it started working as an independent institution in July 2005. By September 2006, HAA had accredited a total number of 68 bodies.

Concerning *conformity assessment*, no particular progress can be reported on the creation of a network of independent certifying bodies and laboratories.

As regards *metrology*, the State Office for Metrology (DZM) employs 114 staff. A new General Director was appointed in March 2006. Pursuant to the new Regulation on the Organisation of the DZM adopted in 2006, an independent Department for Basic Metrology functions as the National Metrology Institute and is responsible, together with national calibration laboratories, for the realisation, management and maintenance of national measurement standards.

Regarding *market surveillance*, no particular progress can be reported regarding administrative capacity and enforcement measures of the State Inspectorate.

In terms of administrative capacity, the Department for Internal Market Coordination within the Directorate for Trade and Internal Market of the Ministry of Economy, Labour and Entrepreneurship (MELE) has become operational and employs three persons. This level of staffing is insufficient as the Department is responsible for overall policy coordination with other ministries and agencies and for the application of Articles 28 – 30 of the EC Treaty and introduction of the mutual recognition principle.

Overall, in the area of horizontal measures, basic structures for harmonisation with EU legislation are in place. However, legal efforts should be matched by adequate capacity building measures to enable Croatian institutions to become full members of relevant European organisations. The adoption and implementation of revised horizontal framework legislation is a priority as well as the segregation of tasks between the various functions (regulatory, standardisation, accreditation, metrology, conformity assessment and market surveillance). Both are key elements for accession negotiations in this chapter.

As regards sectors covered by the **old approach product legislation**, Croatia adopted between September 2005 and April 2006, ten new ordinances aimed at transposing type-approval directives as regards motor vehicles, two- or three-wheel motor vehicles and agriculture or forestry tractors.

As regards *pharmaceuticals*, Croatia has adopted an ordinance aiming at transposing Community *acquis* on good laboratory practice, an ordinance regarding drugs for veterinary medicine. In August 2006, new legislation and a regulation on the criteria for determining wholesale prices of medicinal products were adopted. However, reimbursement decisions and pricing procedures are still not transparent and impartial enough.

A draft Law on General Use Items has been prepared which would provide the legal basis for the adoption of secondary legislation transposing the *acquis* in the field of detergents and cosmetics. Implementing legislation regarding textile and footwear labelling, textile fibre mixtures as well as crystal glass were adopted in November 2005. Further progress in the transposition of Old Approach *acquis* is needed. Substantive efforts are required in the areas of chemicals, pharmaceuticals, cosmetics, legal metrology and with the remaining motor vehicles directives.

As regards **new and global approach product legislation**, progress can be reported regarding legislative alignment with the New and Global Approach directives.

Legislation aiming at transposing the *acquis* on lifts, machinery, gas appliances, low voltage equipment, pressure equipment and simple pressure vessels was adopted in November 2005. Legislation aiming at alignment in the field of non-automatic weighing instruments, radio and telecommunications terminal equipment, electromagnetic compatibility, recreational crafts, explosives for civil use as well as parts of the Community *acquis* in the fields of safety of toys, construction products and medical devices were adopted in 2005. Further amendments are needed in these sectors to achieve full alignment with the *acquis*.

Overall, further alignment with the New Approach *acquis* both on the horizontal and vertical levels (framework legislation and sectoral transpositions) continues to require major efforts. Further amendments to the framework legislation on technical regulations for products and

conformity assessment procedures will be necessary in order to fully align implementing legislation.

Concerning **procedural measures**, a new Weapons Law has been drafted. However, most of procedures embodied in the Directive on control of the acquisition and possession of weapons remain to be implemented.

#### *Conclusion*

Croatia has made some progress to harmonise its national legislation with the *acquis* of the free movement of goods, but it has been uneven progress as many elements of the *acquis* are not yet in place. Adjusting the conformity assessment infrastructure and the market surveillance activities to the requirements deriving from the New and Global Approach is a major challenge. Alignment with the *acquis* in this chapter is underway, but considerable and sustained efforts are still needed to align legislation with the *acquis* and to effectively implement and enforce it.

### **4.2. Chapter 2: Freedom of movement for workers**

There have been no developments on **access to the labour market**. A number of important adjustments still need to be made to Croatian legislation to align it with EU rules on the free movement of workers and the rights of accompanying family members, mainly as regards non-discrimination. No progress can be reported on preparations for participation in EURES.

There has been little progress on **coordination of social security systems**. Sufficient administrative capacity must be developed to apply Community provisions in this field, and pre-accession assistance should be used to this effect.

#### *Conclusion*

Overall, limited progress has been achieved in this chapter. Considerable and sustained efforts will be needed by Croatia under this chapter, particularly in terms of developing administrative capacity for the coordination of the social security systems.

### **4.3. Chapter 3: Right of establishment and freedom to provide services**

Limited progress can be reported regarding the **right of establishment**. In early 2006, the Government changed the decree on the registration fee for ships, yachts and boats eliminating the discriminatory treatment of vessels flying the flag of an EU Member State. However, numerous restrictions on the right of establishment remain, the main obstacles being citizenship and residence requirements, language requirements, restrictions on purchasing property (*see also Chapter 4, Free Movement of Capital*) and the one-office rule.

Certain institutions in the sense of the Institutions Act cannot be set up by foreigners, including EU citizens. The provision of some services, such as tourist guide services, is reserved to Croatian nationals.

There has been no progress regarding the **freedom to provide cross-border services**. At present, Croatian legislation does not provide sufficient legal certainty that cross-border provision of services is possible without establishing a commercial presence in Croatia.

No further progress has been made in the field of **postal services** where the level of legislative alignment is already relatively high. Some outstanding issues have not been addressed, such as a better structuring of the "inspectional supervision" of the providers of postal services, the public financing of the Universal Service Provider (Croatian Post), the inadequate administrative capacity and insufficient funding of the Council for Postal Services as National Regulatory Authority.

No progress could be observed regarding the **mutual recognition of professional qualifications**. Croatian legislation does not distinguish between the recognition of academic and professional qualifications. It also contains nationality requirements which restrict access to certain profession to Croatian citizens and sets out a priori conditions for linguistic skills.

#### *Conclusion*

Limited progress has been achieved in this chapter. Substantial obstacles to the right of establishment remain and further work is required in the field of mutual recognition of professional qualifications. Overall alignment with the *acquis* is at a reasonable level although considerable and sustained efforts are still required in some areas.

#### **4.4. Chapter 4: Free movement of capital**

Some progress can be reported in the area of **capital movements and payments**. Decisions were adopted by the Croatian National Bank (HNB) which lifted some of the restrictions on cash transactions between residents and non-residents, on non-resident cash transactions to and from domestic bank accounts, and on investments by residents in foreign investment funds. Some statements by the head of the HNB on the potential take-over of a Croatian bank by EU-based bank raised questions about the application of objective criteria.

As regards the acquisition of real estate by foreign nationals, amendments to the Property Act were adopted to simplify the authorisation procedure for the acquisition of real estate by foreigners, which will now be managed solely by the Ministry of Justice.

However, the practical effect of the new procedure remains to be seen, particularly given most of the bottlenecks in the system rest with the Ministry of Justice. Improved case management and strengthened staff numbers will be required, not least in view of the growing backlog of pending applications. Preparations for alignment with the *acquis* in this area are underway.

On the whole, the short-term partnership priority calling for a streamlining of procedures for authorising the purchase of real estate by EU nationals on a non-discriminatory basis and substantially reducing the large backlog of applications has been fulfilled only partially.

There has been some progress in the area of **payment systems**. In June 2006, a Decision of the Croatian National Bank entered into force which partially aligned with the Directive on Cross-Border Credit Transfers. Preparations are already well underway in this field.

Some progress can be reported as regards the **fight against money laundering**. Amendments to the Foreign Exchange Act entered into force in December 2005 introducing 'fit and proper' criteria for owners of foreign exchange offices in line with one of the key recommendations of the second MONEYVAL evaluation of Croatia. As of January 2006, the amended Civil Obligations Act no longer allows the opening of bearer pass books, although existing bearer passbooks have not yet been abolished. Memoranda of understanding on exchange of information were signed with the Serbian and Ukrainian Financial Intelligence Units (FIUs).

There is a need for further legislative alignment with the directives as well as the standards of the Financial Action Task Force in this area. Institutional capacity needs to be strengthened. Monitoring and supervision of reporting entities remains inadequate, especially outside the banking sector, and the enforcement record (including convictions, confiscations, seizures and asset freezing) is still weak. Improving anti-money laundering legislation, ensuring effective implementation, strengthening the FIU and improving inter-agency cooperation are all short-term partnership priorities which remain to be fulfilled.

### *Conclusion*

There has been some progress in this chapter. Croatia has further liberalised transactions on the capital account. Despite amendments to the Property Act that appear to be a step in the right direction, Croatia is not complying with the SAA obligation to make "full and expedient use" of its procedures to authorise the acquisition of real estate by EU nationals. Legislation in the area of fight against money laundering needs further alignment and administrative and enforcement capacity should be strengthened. Increased efforts will be needed to meet the requirements of this chapter.

### **4.5. Chapter 5: Public procurement**

No progress can be reported in the fields of general principles and remedies.

As regards the **award of public contracts**, amendments to the Public Procurement Act entered into force in October 2005. Since then, no significant legislative developments have taken place in this sector.

In February 2006, a Decision on the working group for drafting the proposal on implementation of the Public Procurement Act was adopted. In March 2006, the working group for drafting the Concessions Act was established within the Ministry of Finance.

Some implementing measures were issued during the reporting period. A list of public procurement contracting entities, which have to apply the Public Procurement Act, was published in February 2006. The Decree on Amendments to the Public Procurement Announcements and Records Decree was adopted in October 2005. In September 2006, Guidelines for Public-Private Partnership (PPP) were published in the Official Gazette. The Department for PPP was established by Government Decree, within the Export and Promotion Agency (EIPA), to cover the register of PPP contracts, provide instructions and information, risk assessment and to control tendering as well as work on PPP legal framework. The coherence of these provisions concerning PPPs with the legal and administrative framework on public procurement, including concessions, needs to be ensured



Regarding *administrative capacity*, the Public Procurement Office (PPO), has been reorganised into three departments, based on the Decree on Amendments to the Internal Organisation of the Public Procurement Office adopted in October 2005. The PPO published the first issue of the electronic public procurement bulletin on its website, which is a positive step to increase transparency and to provide information to potential bidders.

However, weaknesses in co-ordination of policy making and implementation continue to undermine the coherence of the public procurement system. There is currently no institutional capacity in the field of concessions, with the exception of a registry on concessions held at the Ministry of Finance. Moreover, the PPO staffing levels remain low (19 staff employed by May 2006 out of 24 foreseen in the establishment plan) and further improvements are needed in terms of logistical resources and staff qualifications in order to be able to efficiently design and implement procurement policy.

The State Commission for the review of public procurement procedures has increased its staff numbers to 18 by May 2006. The State Commission registered 746 appeals during 2005. The State Commission has established a record of dealing with appeals promptly, with no significant backlog and publishes its case-law on its website.

### *Conclusion*

Limited progress has been achieved as specific gaps remain to be addressed in relation to concessions, review procedures, implementing capacity, but also on a number of legislative aspects of public contracts. Alignment with the *acquis* in this chapter is underway, but considerable and sustained efforts are needed on the design of a strategy and strengthening of the institutional set-up.

## **4.6. Chapter 6: Company law**

In the area of **company law**, existing legislation is largely aligned with the *acquis*. Some amendments will nevertheless be required, for example in relation to disclosure requirements by limited liability companies and the determination of the offer price in the context of takeover bids.

In the area of financial reporting, good progress in the area of **corporate accounting** took place during the reporting period. A new Accounting Act entered into force in January 2006. Most of the provisions of the Accounting Directives will be transposed through the standards to be adopted by the Croatian Financial Reporting Council (FRC).

The Accounting Act contains a number of provisions referring to the powers of the FRC to issue requirements supplementing International Financial Reporting Standards (IFRS). The Accounting Act already requires a broader application of the IFRS than foreseen in Article 4 of the IAS Regulation, as it applies to all large entities, as well as financial institutions and entities whose securities are listed. There is no special reference to consolidated accounts and a definition of the scope of entities subject to consolidation would ensure clarity of the legal framework. Moreover, enforcement of accounting requirements needs to be monitored.

As regards **auditing**, progress can be reported with the entry into force of the Audit Act in January 2006. However, gaps remain in respect of, for instance, external quality assurance

and public oversight. The Audit Act contains citizenship requirements, restricting EU audit firms from establishment in Croatia, which are not in line with the Stabilisation and Association Agreement (SAA) provisions on establishment. Moreover, the practical application/enforcement of statutory auditing requirements as well as developments in the auditing profession will require monitoring.

#### *Conclusion*

Overall progress under this chapter has been good. Significant legislative changes took place towards alignment in the areas of corporate accounting and auditing. Alignment with the *acquis* in this chapter is well on track, although monitoring and enforcement of corporate compliance requires continued efforts.

#### **4.7. Chapter 7: Intellectual property law**

No particular progress can be reported in the field of **copyright and related rights**. The administrative capacity of enforcement bodies needs to be reinforced, and the legal procedures implementing the rules in this area need to be reviewed. Improvements need to be made as regards the implementation of the directive concerning satellite broadcasting and cable retransmission, in particular as regards compulsory collective management for satellite broadcasting. Overall, alignment with the *acquis* is already well advanced in this area.

No particular progress can be reported in the field of **industrial property rights**. Alignment with the *acquis* is already well advanced in this area.

Some progress can be reported as regards **enforcement**. In September 2005, Croatia adopted a National Strategy for the Development of the Intellectual Property System (2005-2010). It aims at achieving the level of protection granted by the Enforcement Directive through improvements in the legislative and institutional framework, reform of the judicial system and encouraging rights holders to set up further collective rights management associations (CRMA). In November 2005, amendments to the State Inspectorate Act entered into force which expanded its competence in the field of copyright to supervision of circulation and duplication of books. The State Intellectual Property Office (SIPO) recruited and trained 7 junior clerks in January 2006. In 2005, actions to enforce IPR were performed, which gave rise to misdemeanour proceedings concerning computer programmes sound recording media, cinematographic works and video games. Also in 2005, more than 4000 inspections to enforce the Trademark Act were carried out (mainly concerning textile products, shoes and leather goods), which resulted in 102 misdemeanour proceedings. The strengthening of implementing capacity, including through specialised training and improved cooperation among enforcement bodies, remains a challenge.

#### *Conclusion*

Some progress has been made in this chapter, particularly on enforcement. Continued efforts by Croatia should allow for meeting the requirements of this chapter.



#### 4.8. Chapter 8: Competition Policy

Croatia has made some progress under this chapter. In the **area of anti-trust**, including **merger control**, the Competition Act of 2003 contains the basic rules on restrictive agreements, dominant position and merger control, but further alignment is still necessary. In addition to a need for a general fine-tuning of the provisions, a single competition regime still needs to be created to ensure that the Competition Act applies to all sectors, particularly banking and telecommunications. The Croatian authorities should exclude the possibility for the Government to overturn anti-trust decisions on the basis of Article 266 of the General Administrative Procedure Act.

As regards the *administrative capacity*, the Croatian Competition Agency (CCA) has made some progress regarding training activities and case-management. The Agency is well managed and provides strategic statements of its activities. However, in order to cope with the heavy and steadily increasing workload of the CCA and training needs, further resources are needed. In this context, it causes concern that the CCA's budget has not been increased in 2006. Furthermore, the CCA should be empowered to impose fines. The current judicial system is not functioning satisfactorily, and development and training of the judiciary in competition matters is necessary.

As regards the *anti-trust enforcement* record, the Competition Agency (together with the Croatian National Bank, for the banking sector) adopted 93 substantive decisions in 2005, including on restrictive agreements (5)), abuse of dominant position, (3) merger control (26) and advocacy decisions (59). The enforcement record needs considerable strengthening, including economic and legal assessment. Enforcement should focus better on preventing the most serious distortions of competition, in particular in the field of prohibiting restrictive horizontal agreements and exclusionary abuses of dominant position. It is also essential that a whole new system for fining is introduced that allows for sufficiently deterrent sanctioning.

In the area of **state aid**, considerable progress has been made with the adoption of the new State Aid Act and the new Regulation on State Aid, particularly as regards the possibility for the Competition Agency to issue binding decisions on binding decisions on draft State aid provisions. Progress has also been made in the new State Aid Act as regards the non application to the State aid area of Article 266 of the General Administrative Procedure Act on the Government's power to overturn decisions.

The Competition Agency is still in the process of developing its *administrative capacity* as Croatia's national state aid monitoring and control authority. The number of expert staff working on State aid issues has been reduced from nine in 2005 to eight. There is an urgent need to further strengthen the administrative capacity for State aid control as regards staff, budget resources and training.

There has been some progress as regards the *state aid enforcement* record. In 2005, the Agency handled 91 State aid cases (decisions and opinions). The majority of cases was either not considered state aid in the meaning of the Law or was approved as eligible aid. Only four cases were found to be incompatible with the Law. Enforcement continues to be in its infancy, and needs to be strengthened considerably in relation both to the scope and to the economic and legal assessment. In particular, aid grantors continue to ignore the notification obligations or to not provide sufficient cooperation with the Competition Agency. The Croatian

authorities have compiled a list of existing aid schemes and other legal instruments on the basis of which state aid has been granted before the entering into force of the State Aid Act of 2003. As regards fiscal aid, a key element for the accession negotiations, some progress has been made. Alignment with the *acquis* as regards the Profit Tax Act and the Investment Promotion Act is well on track, while the alignment of the Free Zones Act with the *acquis* is still lagging behind. Croatia has yet to submit a proposal for a regional aid map.

As regards the shipbuilding sector, which is a key element of the accession negotiations, the adoption of the strategic guidelines for the future development of the Croatian shipbuilding sector is only a starting point for reflection. Croatia urgently needs to adopt viable restructuring plans for the companies in difficulties in order to comply with the state aid rules of the Stabilisation and Association Agreement and in view of the importance of the industry in Croatia.

In the steel sector, which is also a key element of the accession negotiations, Croatia has made limited progress. The adoption of a draft restructuring programme for the steel industry in Croatia is a positive step forward but not enough for Croatia to fulfil its obligations under the SAA. Essential elements of the plan, namely the industrial strategy, detailed information on the privatisation process and the state aid measures involved as well as the associated compensatory measures are still to be completed.

Given the continued state aid provided to both sectors, viable restructuring plans for shipbuilding companies in difficulties need to be urgently adopted, as well as a restructuring programme that meets the requirements of the SAA for the steel sector.

Croatia adopted the annual State Aid Report for 2005 in July 2006. The report is based largely on the EU methodology.

#### *Conclusion*

Croatia has continued to make some progress, both as regards anti-trust and state aid. However, it needs to intensify its efforts. There is a need for important further legislative alignment, strengthening of administrative capacity, particularly regarding staffing levels, and a more efficient enforcement record. Special attention is needed in order not to violate SAA obligations, in particular as regards state aid to steel and shipbuilding, as well as fiscal aid.

#### **4.9. Chapter 9: Financial Services**

Some progress can be reported in the area of **banking and financial conglomerates**. In June 2006, the Croatian National Bank (CNB) adopted a plan aiming at the full implementation of the EU's new capital requirements framework in January 2009. The CNB also adopted amendments to the implementing decisions under the Banking Act, with a view to integrating recently amendments to IAS/IFRS in prudential reporting requirements.

Some progress can be reported in the area of **insurance and occupational pensions**. New insurance laws entered into force in January 2006. The new laws provide for rules on liquidity management and define in more detail types of technical reserves. Life and non-life insurance and non- life-insurance business has to be separated with an exemption for health and

accident insurances. Both the Insurance Act and the Act on Compulsory Insurance within the Transport Sector largely comply with EU insurance legislation. However, gaps remain with regard to certain prudential requirements, in particular concerning solvency calculation and supplementary supervision of insurance groups. Croatian legislation is not aligned to the minimum level of compensation, as required by the motor insurance *acquis*. Some progress can be reported as regards the **securities market and investment services**. A new institutional framework has been established in November 2005 on supervision of the non banking financial institutions. The Law on the Agency for Supervision of Financial Services merges three institutions dealing with securities, supervision of pension funds and insurance into a single supervisory authority which started operations in January 2006. The agency is independent; however, its administrative capacity needs further reinforcement.

The new Law on Investment Funds was adopted in Parliament in December 2005. The Law further aligns Croatia's legislation to the Directive on Undertakings for Collective Investment in Transferable Securities.

The area of securities market and investment services is partially aligned.

#### *Conclusion*

Some progress has been made in this chapter, significantly so with regard to insurance legislation. The institutional framework overseeing the non-banking financial sector has been clarified. Alignment to the *acquis* in this chapter is moderately advanced. However, increased efforts are required to meet overall requirements of the EU financial services *acquis*.

#### **4.10. Chapter 10: Information society and media**

Progress has continued as regards the **electronic communications and information technologies**. A Telecommunications Users Council was established within the Croatian Agency for Telecommunications as a mediation body in the out-of-court disputes between providers and users of public telecommunications services, and also on the protection of users' rights. The Agency itself has taken important regulatory decisions such as the adoption of a new interconnection offer and the reference offer for unbundled access to the local loop. Also, a decision was taken identifying SMP operators in four relevant products and geographic markets. The Agency is now well staffed and its independence, autonomy, and powers are assured by the law. However, it needs to reinforce its organisation, improve its capacities and demonstrate more transparency and focus in its work, with a solid work programme and regular public consultation procedure.

The current Telecommunication Act from June 2003 has been amended four times up to May 2005. A completely new primary law will need to be drafted, however, in order to align with the *acquis*. *Liberalisation* is slowly emerging as regards the fixed network but the incumbent operator is still dominates. In the mobile market, continued growth and the entry of a third player have translated into significant tariff decreases, but some limitations in regulatory conditions and difficulties in network roll-out may slow down this progress. The broadband market has grown significantly but is highly dependent upon the incumbent operator's offering. Not all access options are offered and infrastructure competition has not been introduced. The concession agreement and other agreements between the State and the

incumbent need to be disclosed and harmonised with the Telecommunications Act, in particular with regard to any limitations to the further liberalisation of the sector.

Some competitive safeguards are still incomplete or are proving difficult to implement, such as carrier selection, number portability, accounting separation and cost accounting systems, reference unbundling offer, leased lines wholesale offer and pricing, rights of way and facility sharing.

Regarding **information society services**, Croatia's Law on Electronic Signature, Law on Electronic Commerce and the Law on Electronic Media implement the general principles of the *acquis* on e-signatures, electronic commerce, conditional access and e-government.

As regards **audiovisual policy**, Croatia's Law on Electronic Media and the Law on Media have transposed a number of provisions of the Television without Frontiers Directive. However, some issues still need to be addressed in Croatian legislation regarding advertising, the majority rule of European Works and independent works, freedom of reception and judicial appeal. Changes to the Criminal Code removing the sanction of prison sentences in libel cases constitute important progress towards European standards (*see political criteria*). However, a review of audiovisual media legislation in line with the recommendations formulated in February 2004 by the joint expertise mission of the Council of Europe, the Commission and the OSCE is still outstanding. In particular, there is a need to review the Law on Electronic Media in order to establish a transparent, predictable and effective regulatory framework and ensure political independence of the Council for Electronic Media. Similarly, the Law on Croatian Radio and Television should be reviewed to ensure its Programme Council can work independently and free from political interference. A broad role for civil society should be found for the nomination procedures for both Councils.

#### *Conclusion*

There has been some progress under this chapter. In most fields concrete steps have been taken to transpose the *acquis* and a detailed analysis of remaining gaps have been made. However, increased efforts are needed to achieve effective liberalisation of the electronic communications market, both in term of legislation and strengthening of the Agency for Telecommunications. A good level of alignment has been reached as regards audiovisual *acquis* but further efforts are needed.

#### **4.11. Chapter 11: Agriculture**

As regards **horizontal issues**, some steps have been taken to prepare for the establishment of the Integrated Administration and Control System and the Land Parcel Identification System as well as for a farm register but these preparations are still at an early stage. A National Committee and an Implementing Agency were established with a view to setting up a Farm Accountancy Data Network. Substantial staff and financial resources will be needed to ensure the administrative capacity that Croatia will need to administrate the Common Agriculture Policy.

No particular progress can be reported on **common market organisations**. The large majority of Croatia's agricultural markets are not in line with the EU requirements, which is understandable at this stage of the enlargement process. Increased efforts will be required to ensure that key elements will be in place at accession, like market intervention, quotas, price

reporting and monitoring, and in particular the EU's system of decoupled direct payments. This represents a substantial task and the efforts in this regard need to be intensified.

With regard to **rural development**, Croatia has made substantial progress related to the implementation of the Special pre-Accession Programme for Agriculture and Rural Development (SAPARD). The Croatian programme for SAPARD was approved by the Commission in February 2006 and the Multi-annual Financing Agreement between Croatia and the EU entered into force on 6 April 2006. The management of the SAPARD programme was conferred on a provisional basis to the Ministry for Agriculture, Forestry and Water Management and to the National Fund within the Ministry of Finance, by Commission Decision of 29 September 2006. This decision marks the date for the SAPARD Agency to start selecting and contracting projects and so far covers the measures "Investments in agriculture holdings" and "Improving the processing and marketing of agricultural and fisheries products". The measure "Improvement of rural infrastructure" is currently being prepared for national accreditation.

Good progress has been made as regards **quality policy** where Croatian legislation has been amended so that a high level of compliance with EU required has been achieved. Agricultural products not intended for human consumption are however not covered. Further efforts are needed as regards the inspection system.

Good progress has also been made as regards **organic farming** where Croatia has achieved a high level of compliance with EU requirements. Croatia has the necessary register of organic operators, authorised testing laboratories and technical inspections.

#### *Conclusion*

Reasonable progress has been made in the field of agriculture in particular with regard to rural development, quality policy and organic farming. Preparations need to be intensified as regards horizontal issues and the common market organisations. In particular, due attention should be given to the establishment of the Integrated Administration and Control System and the Land Parcel Identification System.

#### **4.12. Chapter 12: Food safety, veterinary and phytosanitary policy**

Concerning **general** foodstuffs policy, progress remained limited in transposition and implementation. Croatia needs to implement the fundamental principals of the Food law, namely the responsibility of food and feed operators and traceability. The administrative capacities to fulfil the obligation of registration of establishments and implement the new approach of food and feed controls need to be strengthened.

Some progress has been made as regards **veterinary** issues. The veterinary system in Croatia is in general well functioning but substantial adaptation is still required to achieve full compliance with EU requirements. Croatia has continued to make progress as regards animal registration. An electronic database was set up in May 2003 and was implemented for bovine animals by the end of 2005, although there is still a need for further improvement of certain procedures for instance as regards the marking of calves, issue of animal passports and the deduction of slaughtered animals. Further development is needed for other animals, such as sheep, goats, pigs and equidae.

As regards veterinary checks on third country borders some progress has been made. A plan for rationalisation of border inspection posts has been developed but needs further refinement. 8 external border inspection posts are foreseen after accession at the present stage. There is a substantial need for infrastructure investments and upgrading of staff qualifications.

As regards animal disease control measures, Croatian authorities reacted swiftly to control the Avian Influenza outbreak end of 2005. Croatia continues its non-vaccination approach for Classical Swine Fever (CSF) that was introduced in 2005. This represents a positive development with a view to EU requirements, but in view of recent sporadic outbreaks, there is a need for further monitoring and assessment. A programme of active surveillance of CSF among wild boars is taking place. Disease notification is taking place in accordance with the procedures determined by the World Organisation for Animal Health which gives a good basis for meeting EU requirements.

With regard to the **placing on the market of food and feed**, progress has been relatively limited. Establishments for food processing, such as slaughterhouses, meat processing plants and dairies, do in general not comply with the requirements of the EU as regards hygiene standards. Substantial efforts will be required to elaborate the detailed plans needed to bring Croatia's food processing establishments in compliance with EU requirements at accession. There is also a need for further improvement of laboratory capacity in the food safety field. The progress in this field is closely linked to the implementation of the Food Safety Strategy.

In the field of animal welfare, only limited progress has been made. An Animal Protection Law is being drafted that will serve as a framework for implementing legislation in the field.

No development can be reported in the areas of **specific rules for food** and **specific rules for feed**.

Good progress has been made in the area of **phytosanitary** issues although substantial further efforts are required in particular as regards implementing legislation and enhancement of administrative capacity. Pursuant to a Decree of May 2006 the phytosanitary activities of the Ministry of Agriculture, Forestry and Water Management were reorganised with a view to better supporting the preparations for EU accession. There is, however, still a need to enhance staff numbers and qualifications as well as the general administrative capacity.

Good progress was made in the area of plant health. Implementation of the new Plant Health Act started in January 2006. The Act aims at harmonisation with the provisions of the *acquis* regarding harmful organisms. On the basis of this Act, a substantial number of implementing ordinances are under preparation. Activities related to the control of harmful organisms were enhanced, in particular as regards systematic surveys for certain harmful organisms. The number of examination sites was increased. Phytosanitary border inspection posts do not meet the minimum EU requirements and further improvement is needed in infrastructure and staff qualifications, aiming in particular at those inspection posts that will remain after accession.

Good progress was also made in the field of plant protection. The Plant Protection Products Act that will enter into force in 2007 aims at harmonisation with the EU *acquis* on the marketing of plant protection products. A number of implementing ordinances were issued in



the second quarter of 2006 on evaluation of active substances and on the evaluation and authorisation of plant protection products.

Progress has also been made as regards the area of seed production and plant reproduction material. The new Act on Seeds, Planting Material and Registration of Varieties of Agricultural Plants was adopted by Parliament at the end of 2005 aiming at a high degree of compliance with EU requirements. Implementation will only take place in 2008. A substantial amount of implementing legislation will be required to ensure full compliance in this field.

### *Conclusion*

Some progress has been made in the field of food safety, veterinary and phytosanitary policy. Substantial efforts are however required in order to accelerate the preparations. The Food Safety Strategy needs to be officially approved as a matter of priority and the on-going preparations for remaining framework legislation must be finalised.

### **4.13. Chapter 13: Fisheries**

The *acquis* on fisheries consists of regulations, which do not require transposition into national legislation. However, it requires the introduction of measures to prepare the administration and the operators for participation in the common fisheries policy, which covers market policy, resource and fleet management, inspection and control, structural actions and state aid control. In some cases, existing fisheries agreements and conventions with third countries or international organisations need to be adapted.

Some developments can be reported in the areas of **resource and fleet management** and **inspection and control**. Based on the amended Marine Fisheries Act, Croatia adopted several implementing regulations introducing notably new temporal and spatial restrictions on fishing, restrictions on engine power and on the issuing of new licences for commercial fishing as well as a framework for better data collection. Their scientific basis and alignment with the *acquis* remain to be assessed. Croatia also adopted implementing regulations providing the legal base for establishing an aligned fleet register and the installation of a satellite based vessel monitoring system (VMS). Five additional inspectors were recruited for control at sea. A number of technical differences to the *acquis* remain in the area of resource management and Croatia does not yet have a compatible fleet register, fleet management measures, VMS or landing declarations. Preparations in these areas are being launched.

No particular progress can be reported with regard to **market policy**. Currently Croatia does not yet have producers' organisations and uses different marketing standards. Preparations in this area are at an early stage.

There has been no particular progress in the areas of **structural actions** and **state aid**. Croatia still needs to create the necessary administrative structures for the implementation of the EU's structural policy. It will also have to remove state aid incompatible with the *acquis* such as the current fleet construction programme. Preparations in both areas are at an early stage.

No particular developments can be reported in the area of **international agreements** where Croatia has already reached a considerable level of alignment.

### *Conclusion*

Croatia has made some progress in the field of fisheries. Overall, Croatia has reached a satisfactory level of alignment in its preparations for accession. Important gaps remain in the areas of fleet management, inspection and control, structural actions and state aid. Croatia will need to make increased efforts to close these gaps

#### **4.14. Chapter 14: Transport policy**

Progress can be reported in the field of **road transport**. Progress was made in alignment to the *acquis* through the adoption of ordinances on the transport of hazardous substances by road, on safety advisors, and speed limitation devices. Concerning social rules, further progress needs to be made on working time, on the new rules on driving time and resting periods and on the introduction of the digital tachograph. Efforts are also needed in the area of access to the occupation (professional competences). The legislation covering taxes, tolls and road user charges still needs to be aligned with the *acquis*. A national programme for road safety was adopted in February 2006. However, the adoption of implementing legislation on weights and dimensions, tunnels safety and driving licenses is still outstanding.

Administrative capacity for the implementation and enforcement of legislation remains limited. No new staff was recruited in the relevant departments. A working group with members from the Ministry of Sea, Tourism, Transport and Development and the Ministry of the Interior was established in November 2005 to improve the coordination and prioritisation of topics concerning alignment to the *acquis*. Preparations in this area are underway.

There has been some progress in the area of **rail transport**. The Railway Act entered into force in 2006. In December 2005, the Act on the Division of the Croatian Railway Company was adopted, and a small holding with four different operational daughter companies, i.e. traction, passenger, freight and infrastructure is under establishment. A network statement has not yet been published by Croatia. Implementing legislation was adopted concerning safety certification, on licensing of railway undertakings and on railway infrastructure; the alignment with the *acquis* remains to be confirmed. However, transposition of safety legislation and the establishment of the different rail authorities remain outstanding. The railway directorate in the Ministry of the Sea, Tourism, Transport and Development was reorganised to establish a separate entity dealing with safety. The Croatian authorities have established contact with the European Railway Agency. Preparations in this area are at an early stage.

Concerning **combined transport**, the Law on ratifying the Memorandum of Understanding on the participation of Croatia to the Marco Polo Programme was adopted in September.

No particular progress can be reported in the area of **inland waterways transport**. The legislation on access to the market and to the profession remains to be aligned. The alignment with the *acquis* of legislation of technical requirements remains to be confirmed. A strategy for the alignment of the Croatian inland waterways sector is under preparation. Administrative capacity in the sector remains generally adequate. The International Commission for the Sava basin, with its seat in Zagreb, started its work in January 2006. This Commission aims to facilitate the revitalisation of the Sava navigation route and addresses issues concerning river basin management, navigation, accident prevention and control, and flood prevention. Preparations in this area are still at an early stage.

There has been good progress in the area of **air transport**. Croatia has adopted an ordinance on the investigation of accidents. An ordinance on ground handling services and slot allocation was adopted, aimed at full alignment with the *acquis*. Croatia has signed the Agreement on the establishment of a European Common Aviation Area (ECAA). by signing the European Common Aviation Area Agreement (ECAA), Croatia has undertaken to integrate into the EU internal aviation market and to apply EU aviation standards. This will require the application of the ECAA agreement in practice and the fast implementation of the first transitional phase of the relevant aviation *acquis*, including market access conditions, safety, security, airport policy, environmental and social issues and air traffic control, in line with the Accession Partnership short term priority. The compliance of Croatia's legislation on aviation security with the *acquis* remains to be verified. Reinforcing the administrative capacity in the aviation sector should be an immediate priority for Croatia and the establishment of an independent accident investigation body remains outstanding. Overall preparations in this area are underway.

Good progress can be reported in the area of **maritime transport**. Ordinances have been adopted aimed at alignment with the *acquis* on port reception facilities and pollution prevention, on the minimum level of training of seafarers and working time of seafarers, on marine equipment, and on port state control. The detention rate of Croatia-flagged ships has improved from 7.8% in 2004 to 4.9% in 2005. Croatia has adapted its rules on vessel registration fees in order to comply with the requirements of the SAA concerning market access. However, further alignment concerning classification societies, port state control, vessel traffic monitoring, marine equipment, fishing ships, the safety of roll on-roll off ferries, the minimum level of training of seafarers and the registration of persons sailing on passenger ships is still outstanding. Croatia also remains on the grey list of the Paris Memorandum of Understanding. Further alignment is also still required to align to the *acquis* on maritime cabotage and the freedom to provide international maritime transport services. As regards maritime security, Croatian legislation is partially aligned with the *acquis* concerning port security. Preparations in this area are underway.

### *Conclusion*

Overall, there has been good progress in this chapter. Croatia needs to make increased efforts to align with the *acquis*, notably by further adoption of implementing legislation. Reinforcement of administrative capacity (both in staff numbers and in level of training) also remains a matter of priority for most transport sectors.

## **4.15. Chapter 15: Energy**

In the area of **security of supply** good progress was made with the establishment of an oil stock agency. Croatia currently holds stocks equivalent to 71.9 days of annual consumption, which needs to be raised to 90. Alignment in this area is underway.

There has been good progress in the area of the **internal electricity and gas markets**. A regulatory body established in 2005 currently employs 34 persons. Its administrative strengthening is a matter of priority. The state-owned electricity company HEP has been restructured into a holding company. However, all unbundled assets remain in the ownership of the holding company. In addition to the transmission system operator, there is also a market

operator. The state gas company INA holds a monopoly as the only supplier and importer. Croatia ratified the Energy Community Treaty in June. Alignment in this area is on track.

As for **state aids** to the coal industry, Croatia no longer produces coal domestically.

Limited progress can be reported in the field of **energy efficiency** and **renewable energy sources**. Ordinances on hot-water boilers and household appliances were adopted. Croatia is partially aligned with the directive on the energy performance of buildings. There is no guarantee of origin for renewable energy and for combined heat and power yet. No target for renewable electricity for 2010 has been set. To align with the *acquis*, Croatia's target for the share of renewable electricity must include all hydropower. A target for biofuels has been set in line with the *acquis*. Administrative capacity requires significant strengthening. Alignment has well begun, but needs continued efforts.

Limited progress has been made on **nuclear safety and radiation protection**. Of two storage facilities, only one is licensed. Legislative alignment continued, but is still outstanding concerning foodstuffs, radioactive waste management, radiological emergencies and for the control of high activity radioactive sealed sources. An inventory of sources was established only for medial sources. Spent sources are stored in pools existing in the hospitals until activity decreases below the exemption levels. The State Office for Nuclear Safety (SONS) became operational in June 2005 but only 12 of its 18 staff positions are filled. A clear division of responsibilities between SONS and the similarly understaffed State Office for Radiation Protection needs to be ensured. The ECURIE agreement with the Community has been signed.

#### *Conclusion*

Overall, there has been some progress, including on security of energy supply and on the internal energy and gas market. However, increased efforts are needed, particularly on energy efficiency, nuclear safety and regulatory strengthening. The Accession Partnership's short-term priorities have been mostly met.

#### **4.16. Chapter 16: Taxation**

No progress can be reported in the area of **indirect taxation**. Croatian tax legislation concerning *VAT* and *excise* duties remains only partially aligned to the *acquis*. Discrepancies to the *acquis* in the field of VAT include amongst others certain reduced and zero-rates applied in Croatia, the scope of tax exemptions, the inclusion of free zones in the tax-territory, the special schemes and the introduction of VAT refunds to non-established traders. Also, the system of excise duties will require substantial changes regarding for example product coverage, rates and duty suspensions. Alignment in the area of indirect taxation is at an early stage.

Limited progress was made in the area of **direct taxation**. Amendments to the Law on Profit Tax were adopted in May 2006 and will enter into force in January 2007 with the objective of aligning certain special fiscal regimes to the state aid *acquis* (see Chapter 8, *Competition*) and the code of conduct for business taxation. Divergences to the *acquis* remain with regard to the merger, interest and royalties, and savings directives. Croatia furthermore needs to avoid

introducing tax measures which would be against the principles of the code of conduct for business taxation. Alignment in the area of direct taxation is at an early stage.

Some progress can be reported with regard to **administrative cooperation** and operational capacity. The new division for international cooperation and European integration set up within the Tax Administration became operational in late 2005. It is foreseen to become the future Central Liaison Office and has 11 staff members. A 'Financial Police' created in 2004 to curb fraud became operational in January 2006 and focuses mainly on excise duties. Some steps have been taken to strengthen the IT-divisions of the Tax Administration. However, these divisions remain strongly dependent on external companies, with very limited internal capacity to guarantee the continuity of the IT services. IT-interconnectivity with the Community systems needs to remain a priority for the authorities. Despite ongoing efforts to improve performance, the overall administrative capacity of the Croatian Tax and Customs Administrations (the latter being responsible for excise duties) remains limited and preparations are only starting.

#### *Conclusion*

In the area of taxation Croatia has made limited progress. While the overall structure of tax legislation is similar, Croatian tax legislation is at an early stage of alignment with the *acquis*. Significant efforts are needed to accelerate alignment and to strengthen the Tax Administration, including with regard to IT-interconnectivity, in order to make sure that Croatia is in a position to implement and enforce the *acquis*.

#### **4.17. Chapter 17: Economic and Monetary Union**

In the field of **monetary policy**, no progress can be reported. Croatia will need to continue to implement the necessary changes to its institutional and legal framework. In particular, the HNB (Hrvatska Narodna Banka) has to adopt a secondary objective that allows for general economic objectives of the European Community taking precedence over domestic objectives. In addition, it has to adopt the relevant rules and structures related to the integration of the HNB into the European System of Central Banks by the time of EU-accession.

The provisions in the Croatian legislation only provide for a partially independent central bank. Several provisions, in particular concerning institutional and personal independence are not compliant with the *acquis*. A draft proposal for a new Croatian National Bank Act was formulated in April 2006. There are still some provisions in the Croatian legislation that do not preclude monetary financing of the public sector and give rise to privileged access of public authorities to financial institutions. Overall, preparations in the area of monetary policy are well on track.

In the area of **economic policy**, the country has made some progress in its alignment with the *acquis*. In particular, the Pre-accession Economic Programme (PEP), which was submitted to the Commission in November 2005, provided a sound basis for economic policy coordination in the medium term (2006-2008) since quality significantly increased compared with the previous PEP. The medium-term fiscal framework adopted by the Government as well as the Budget Act set objectives in line with *acquis* reference values. Pursuant to the Government's Economic and Fiscal Policy Guidelines 2006-2008, Croatia has started in 2006 the

implementation of the ESA 95 methodology for the purpose of statistical reporting to the EU within the framework of fiscal surveillance.

However, several ministries and government agencies have varying degrees of responsibility in key and interrelated economic policy areas. The strong fragmentation of responsibilities hampers the effectiveness of policy formulation and implementation. As result, key decisions on economic policy are often delayed. Nonetheless, in the area of economic policy, Croatia is fairly advanced.

#### *Conclusion*

There has been some progress in the area of economic and monetary union. However, further efforts have to be made, in particular with respect to full Central Bank independence. Preparations to align with the *acquis* are well under way in this chapter.

#### **4.18. Chapter 18: Statistics**

Concerning **statistical infrastructure**, the strategy for the development of official statistics for the period 2004 – 2012 and the Programme of Statistical Activities for 2004 – 2007 have been adopted. These documents, together with the Annual Implementation Plan, define long-term objectives, general principles and criteria regarding the functioning and development of the statistical system. Important managerial decisions in the Croatian Bureau of Statistics (CBS) and other strategic decisions are hindered by a long-term senior management vacancy (since June 2005).

With regard to administrative capacity and enforcement, the budget allocated to the CBS for 2006 has been reduced considerably and constitutes a threat to basic statistical activities of the CBS. The CBS lacks staff in the vital IT department as well as in the Project Implementation Unit, responsible for all donor activities.

As regards the implementation of **classifications**, continued progress is needed. The basic classifications and statistical registers are already implemented. However, further work has to concentrate on the improvement of the coverage and quality of the business registers and the preparation of implementation of the future changes of the NACE nomenclature.

In the area of **sector statistics**, Croatia needs to step up efforts in agricultural statistics especially with a view to obtaining comparable agricultural structure, agromonetary and dairy data. Progress can be reported from the economic and monetary statistics where the ESA 95 was widely introduced. Further work should concentrate on methodological fine-tuning and the introduction of financial accounts. As far as public finance statistics are concerned, a twinning project has started which will allow the CBS, the Ministry of Finance and the Central Bank to develop public finance statistics according to the *acquis*.

#### *Conclusion*

Good progress has been made in this chapter. Improvements can be reported in the main statistical areas. However, continued efforts, and sustained national funding are inecessary if Croatia is to meet the requirements of this chapter.



#### 4.19. Chapter 19: Employment and Social Policy

In the area of **labour law**, the Ministry of Economy, Labour and Entrepreneurship launched in June 2006 a wide consultation process with economic and social partners in order to agree an action plan for the adoption and/or amendment of regulations necessary for transposing the *acquis*.

Concerning **health and safety at work**, no new legislation transposing the *acquis* has been adopted. The Labour Inspectorate needs substantial strengthening, and it needs to become more mobile.

As regards **social dialogue**, a number of activities have been undertaken relating to the provision of support to social partners in capacity building, and in particular through bipartite social dialogue. There is still scope, however, for improvement in this area. In general, tripartite dialogue seems to be well developed in Croatia. However, clarification on the criteria for including employers' associations other than the Croatian Employers' Association in the work of the Economic and Social Council is needed.

In the area of **employment policy**, in March 2006 the Government adopted an annual programme for the promotion of employment in line with the provisions of the National Employment Action Plan 2005-2008. The funds allocated for the implementation of this programme amounted to HRK 335 million for 2006. Launched in September 2005, work under the Joint Assessment of Employment Policy Priorities (JAP) process has been relatively modest. A roadmap has been agreed for its completion. Despite some reduction in recent years, the unemployment rate remains high in Croatia. Regional inequalities are also considerable and qualification and skills levels of the Croatian labour force are lower than in the EU. Attention should be paid to undertaking active labour market measures, as well as to adult education and training. Efforts should also be pursued to tackle illegal work.

Preparations for the **European Social Fund** work have started in particular in the framework of the IPA pre-accession instrument and its component VI on human resources development. In this context, work has started on the relevant programming documents including the single Operational Programme.

As regards **social inclusion and social protection**, work on the Joint Inclusion Memorandum process (JIM) between the EU and Croatia is well advanced. In terms of social exclusion and poverty in Croatian society, much remains to be done. A more strategic approach to social benefit reforms is necessary in order to provide more effective support for the most vulnerable groups of the population. Concerning people with disabilities, sufficient financial resources should be allocated in order to ensure implementation of the National Strategy for the Disabled.

There has been limited progress in the **anti-discrimination** field. A comprehensive national strategy for the elimination of discrimination still remains to be adopted. There has been no new legislation transposing the *acquis* in this field; nor has there been progress in the establishment of the Equality Body. Serious attention should be paid to availability of sufficiently comprehensive statistical data to allow monitoring of discrimination.

There have been some developments in the field of **equal opportunities**. Shortcomings with respect to parental leave are being addressed and the review of the Croatian legislation on occupational pension schemes is underway. In September 2006, the Government adopted the National Policy for the Promotion of Gender Equality 2006-2010 (*see also political criteria*).

In terms of *administrative capacity*, a new Regulation on Internal Organisation of the State Inspectorate was adopted, which increased the number of inspectors by 50, and the Act on Amendments to the State Inspectorate Act widened the powers of inspectors and introduced more stringent criminal sanctions. An initiative has also been launched to set up special departments and chambers within the courts to deal with procedures in civil suits deriving from labour related disputes. An internal reorganisation was undertaken at the Ministry of the Economy, Labour and Entrepreneurship resulting in the establishment of a new Department for Project Preparation and Monitoring within its Directorate for Labour and Labour Market. Of the total six staff required, four have already been hired. A new department with four full-time employees has been established in the Croatian Employment Service.

#### *Conclusion*

There has been limited progress in this chapter. Specific gaps remain to be addressed particularly in relation to administrative capacity, which remains weak and which is a key element for the accession negotiations in this chapter. Overall considerable and sustained efforts are needed to meet the requirements of the social policy and employment *acquis*.

#### **4.20. Chapter 20: Enterprise and Industrial Policy**

Notable but uneven progress has been made in the area of **enterprise and industrial policy principles**. Croatia has initiated preparations for a comprehensive industrial strategy aimed at improving its industrial competitiveness in line with EU policy principles. With regard to privatisation, no particular developments can be reported concerning large state-owned companies and utilities outside the portfolio of the State Privatisation Fund. The portfolio of the State Privatisation Fund still comprises of 965 companies of which 68 are majority state-owned. The remaining 897 represent minority participation, with the State owning less than 50%. In 848 companies, the State holds less than 25%.

Good progress can be reported in the field of the business environment and SME policy. Croatia has further extended the services provided by the one-stop system for companies. Time for company registration has been limited to five days and online registration is now possible in the crafts sector. Croatia has introduced initial regulatory impact assessments but there remains scope for improving the quality and regularity of consultation between government and the business community on relevant draft legislation. Croatia has also launched a project aimed at reducing regulation redundancies and consequently lowering regulatory burdens on the business sector. Croatia has continued to successfully implement the European Charter for Small Enterprises. Croatia's SME definition is largely in line with that of the EU. Preparations in the area of business environment and SME policy are well advanced while the development of an industrial strategy and privatisation require further attention.

Some progress has been made in the area of **enterprise and industrial policy instruments**. In July 2006, Croatia initiated the procedure for participating in the EU's Competitiveness and

Innovation Programme. Croatia has to a large extent transposed Directive 200/35/EC combating late payments in commercial transactions. Preparations in this area are well underway.

Limited progress was made with regard to **sectoral policies**. Some sectoral industrial strategies, such as for textiles, are being prepared. In March 2006, Croatia adopted a targeted support programme for the tourism sector. With regard to restructuring of industrial sectors, Croatia has not yet adopted restructuring plans for its shipbuilding companies. This sector is of high importance to the country and requires urgent and significant restructuring, given its deficit in global competitiveness compensated by large scale government subsidies. Concerning steel, Croatia has made some progress towards a National Restructuring Programme for the steel sector. A draft programme has been sent to the Commission in June 2006 and is currently being revised. These programmes urgently need to be adopted in order to comply with state aid rules and with SAA obligations (*see also Chapter 8, Competition Policy*). Preparations in this area are at an early stage.

#### *Conclusion*

Croatia has made notable but uneven progress in this chapter. Good progress in the area of business environment and SME policy contrasts with limited progress in the fields of industrial strategy as well as privatisation and restructuring, in particular in the steel and shipbuilding sector, where increased efforts are required. Overall, Croatia has achieved a reasonable alignment with the *acquis* in this chapter.

#### **4.21. Chapter 21: Trans European Networks**

Good progress can be reported in the area of **transport networks**. Croatia is actively participating in the development of the Core Regional Transport Network and in the South East Europe Transport Observatory (SEETO) but has not yet signed the SEETO Agreement. Croatia needs to ensure transmission to SEETO of complete traffic and transport data on the core regional transport network. Croatia also signed a memorandum on the establishment of a high performance railway network in South East Europe in May 2006.

Continued cooperation is required in the context of the annual revisions of the plans in order to make further progress on the definition of regional priorities and the coordination of investments.

There has been some progress in the area of **energy networks**. Croatia ratified the Energy Community Treaty in June 2006. The Treaty establishes a regionally integrated market for electricity and gas, based on the relevant *acquis* on the internal energy market, renewable energy sources, environment and competition. Interconnection is of vital importance for the proper functioning of the Energy Community. Croatia's priorities include the development of an LNG terminal on the Adriatic coast and development of access to gas from the Caspian region through Turkey. Croatia also prioritises the gas and electricity interconnections with its neighbouring countries. Croatia is encouraged to increase its interconnection, which is vital for creating an effectively functioning regional energy market.

#### *Conclusion*

Some progress can be reported in this chapter. However, the development of a long term transport and energy infrastructure programme with clear timetables and financing strategies is still outstanding. Overall, implementation of the *acquis* in this chapter requires continuous efforts by Croatia.

#### 4.22. Chapter 22: Regional Policy and Coordination of Structural Instruments

Some progress can be reported regarding the **territorial organisation**. Croatia has made proposals regarding the establishment of statistical and planning regions at Nomenclature for Territorial Statistical Units (NUTS) II level, which are being discussed with the Commission. However, there continues to be a lack of adequate regional statistics. Preparations in the area are still at an early stage.

Progress has been limited regarding the **legislative framework**. A draft law on regional development has been prepared but remains to be adopted. The coherence between the national legislation and the Structural funds regulations as well as other Community legislation, namely competition and state aids still needs to be ensured. Preparations are still at an early stage in this area.

There has been some progress regarding the **institutional framework**. A Central State Office for Development Strategy was created in May 2006. This State Office is the IPA coordinator and it will be in charge of programming national and regional development policies. Identification of future operational structures for the implementation of the IPA instrument and structural interventions is progressing well. Inter-ministerial coordination and the consultation with partners need further strengthening. Preparations in this area are under way.

Progress has been limited regarding **administrative capacity**. Management capacities as well as the capacities of Programme Implementing Units (PIU) vary between different ministries. Strengthening administrative capacity remains a priority for Croatia to be able to benefit effectively from the cross-border cooperation, regional and human resources development components of the IPA instrument from 2007. Preparations in this area are still at an early stage and accreditation of the relevant implementing structures should be started as soon as possible to avoid delays in the dispersal of funds.

Good progress can be reported regarding **programming**. The Central State Office for Development Strategy coordinated the elaboration of a Strategic Development Framework for 2006 – 2013 through the inter-ministerial coordination working group. The competent line ministries are in the process of preparing programming documents with relevance for IPA in Croatia, which bridges towards Structural Funds. Preparations in this area are being initiated with the preparation of the Multi Annual Indicative Planning Document (MIPD), the Strategic Coherence Framework and Operational Programmes. In addition, several counties are preparing programming documents with relevance for the structural funds.

There has been some progress regarding **monitoring and evaluation** and **financial management and control** (*see also Chapter 32 – Financial Control*). However, standard methodologies and common cross-sectoral procedures still need to be developed and financial control systems need to be continuously reinforced. Preparations are still at an early stage in this area.

### *Conclusion*

Some progress can be reported in this chapter. However, Croatia still needs to make considerable and sustained efforts to establish the necessary framework and structures for the implementation of the Structural and Cohesion Funds. Overall, Croatia's alignment with the *acquis* in this chapter remains modest.

#### **4.23. Chapter 23: Judiciary and fundamental rights**

As regards the **independence of the judiciary**, there have been some developments.

Amendments to the Law on the State Judicial Council adopted in December 2005 establish a Disciplinary Council, consisting of three members, and extend the time limit for initiating disciplinary proceedings from two to three years. A new Law on Courts, also adopted in December 2005, includes more elaborate and verifiable evaluation criteria for the work of judges, obligatory training for judges, and the introduction of a judicial inspection. These new provisions now need to be implemented.

In 2005 disciplinary proceedings were brought against judges in eight new cases, and measures were taken in three cases, including two fines and one dismissal. However, as private parties do not have standing to initiate or request disciplinary proceedings against judges, a large number of complaints are instead lodged with the ombudsman, who has no competence to examine complaints concerning the judiciary. Private parties need to be given an appropriate forum for complaints and disciplinary proceedings need to be processed in a more transparent way.

There is still no system in place which would ensure a uniform, objective and transparent assessment of judges and judicial trainees wishing to enter into the profession (such as a competitive examination and/or interviews). The State Judicial Council continues to make judicial appointments based on the opinion of local Judicial Councils, which are in turn based on written applications. Procedures for the appointment of both judicial trainees and of court presidents by the Ministry of Justice need to be reviewed to ensure transparency and the use of objective criteria. Some of the current problems in the judicial system are attributable to the number of judges lacking the appropriate competence and experience, and to judicial appointments based on political suitability rather than professionalism.

Judges are initially appointed for a period of five years. They assume office permanently only thereafter, following a positive assessment. Measures are to be taken to make judges irremovable unless in the context of sanctions, incapability or voluntary resignation.

A judge may generally not be detained or have criminal proceedings instituted against him/her without the approval of the State Judicial Council. The provision on penal *immunity* needs to be re-assessed in line with the need for transparency and accountability within the judiciary.

As regards the **impartiality of the judiciary**, there have been limited developments.

The main shortcomings with respect to the need for impartiality of the judicial system continues to be risks of corruption and the undue influence of particular economic and other interests, as well as the prevalence of ethnic bias against Serbs. A new Code of Judicial Ethics laying down ethical principles and rules of conduct for judges has not yet been adopted.

As regards **professionalism and competence** in the judiciary, there has been limited progress.

In the area of training, the Judicial Academy increased its staff by one to 14. Funding has been doubled to €0.4 million. However, three of the five planned regional centres are still not fully operational, and funding and staffing need further improvement. A clear vision is required in order to move away from the current ad hoc curriculum to more strategically planned training based on the medium to long-term needs of the Croatian judiciary. The Academy needs to step up its activities in order to broaden its “clientele”, ensuring that it trains all judges, judicial trainees, judicial advisors, prosecutors and court staff on a systematic and regular basis.

In relation to the **efficiency of the judiciary**, there has been some progress.

The total *budget* for the Croatian judiciary was approximately €291 million in 2006, up 8% from 2005.

As regards *infrastructure and equipment* of courts, there has been good progress particularly in digitalising land registries. Significant further investments are still needed, however, especially to improve IT in Courts and State Prosecutors offices. While still not operational, there has been some progress towards an integrated case management system. It will be important to make progress also on the use of random case allocation measures.

The Law on Courts adopted in December 2006 introduced changes to the possibility of merging some of Croatia’s 248 courts in an effort to rationalise the court network. Mergers of misdemeanour and municipal courts have now begun on a pilot basis following adoption of implementing legislation in April 2006. However, while criteria for rationalisation appear in the judicial reform strategy, there is a clear reluctance to implement the necessary measures. In general Croatia has too many courts, and further mergers and closures are inevitable. Also, at 1935, the total *number of judges* in Croatia remains high relative to total population. There are also 322 judicial trainees, 521 judicial advisers and over 6,000 court clerks.

Some headway has been made in reducing the *backlog of pending cases*. The total number of pending cases was 1.23 million at the end of June 2006, compared to 1.64 million last year. In this context various short-term steps were taken such as continued redistribution of cases from over-burdened to less burdened courts, extra overtime for judges and the use of notaries for the execution of non-disputed decisions. However, the backlog remains significant. The impact of some of these measures has been mitigated by resistance from the parties to the cases. Also, the State continues to contribute to the backlog by continuing to engage in litigation where there is little chance of success.

Particular progress was made in reducing the backlog of *enforcement cases*, including through the use of notaries for the execution of non-disputed decisions. However, enforcement cases still make up around one quarter of all pending court cases and procedures for the enforcement of court decisions need to be further reformed. Execution and enforcement cases are the main problem in 93% of the courts. Croatia needs to consider taking the enforcement process out of the hands of the courts, for instance through the use of special enforcement officers vested with public powers. Courts and parts of the state administration themselves do not always respect or execute in a timely manner the decisions of higher courts. This practice is contributing to cases against Croatia before the ECtHR.